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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. [redacted] 152

TRUST COMPANY OF GEORGIA, Executor Under the Will of Carling Dinkler, Sr.; CARLING L. DINKLER, JR., and CORNELIA V. DINKLER; and TRUST COMPANY OF GEORGIA, Executor Under the Will of C. L. Dinkler, Sr., and MRS. JOEL W. DINKLER, Surviving Wife,

Petitioners,

v.

AUBREY C. Ross, District Director of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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v.

AUBREY C. ROSS, District Director of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled case on December 20, 1967.

CITATIONS TO OPINIONS BELOW

The opinion of the Court of Appeals, printed in Appendix A attached to this petition, *infra*, pp. A1-A5, is reported in ____ F2d ____. The opinion of the United States District Court for the Northern District of Georgia, printed in Appendix A, pp. A7-A28, is reported in 262 F. Supp. 900.

JURISDICTION

(i) The judgment of the Court of Appeals was entered on December 20, 1967 (R. Vol. III, 301).

(ii) Rehearing was denied on March 7, 1968. (R. Vol. III; 375).

(iii) The jurisdiction of this Court is invoked under 28 U.S.C.A. Sect. 1254(1).

QUESTION PRESENTED

Do the proceeds of a sale of stock pursuant to a conditional executory contract signed by a decedent prior to his death and ultimately performed by his executor, after having been amended subsequent to the decedent's death, constitute income in respect of a decedent within the meaning of Section 691 of the Internal Revenue Code of 1954?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are: Internal Revenue Code of 1954, Sections 691 and 1014; Treasury Regulations, Sections 1.691(a)-1, 691(a)-2. The relevant parts of these sections are printed in Appendix B, *infra*, pp. B1-B5.

STATEMENT

Carling Dinkler, Sr., individually, Carling Dinkler, Sr., as Trustee for Carling Dinkler, Jr., Carling Dinkler, Jr., individually, and Dinkler Hotels Company, Inc., entered on August 4, 1960, into an executory contract to sell substantially all of the assets and properties comprising the Dinkler Hotel chain to Associated Hotels Corporation, a Delaware corporation. The properties which were the subject of the executory contract to sell consisted of all of the stock of Dinkler-Tutwiler Corporation and Dinkler-Forsyth Corporation, and all the assets of Dinkler Hotels Company, Inc., including all of the stock of Dinkler Tutwiler Operating Company, Inc., Andrew Jackson Operating Company and Hotel Dinkler Plaza Operating Company, the latter owning all of the stock of Belvedere Corporation.

The Purchaser was organized only two days before the contract was signed and had paid-in capital of only $45,000. The sales price, as subsequently adjusted pursuant to the terms of the contract, was $11,207,959, of which $4,492,959 was to be paid by demand notes at the closing and the balance of $6,715,000 in cash. (R. Vol. II, 145). Of this cash, $500,000 was earnest money deposited by the Purchaser, $300,000 on the signing of the contract and $200,000 on December 20, 1960, when the closing date was extended from January 3, 1961 to a date no later than March 1, 1961. This left a balance of $6,215,000 for Associated Hotels Corporation to produce at closing.

Included among the assets to be sold was the Dinkler-Tutwiler Corporation stock, all owned by Carling Dinkler, Sr., at the contract price as adjusted of $3,539,948 (R. Vol. I, 47). It is the taxability of the gain from this sale, which took place after Mr. Dinkler's death, that is in issue here.

In the event of a default by the Purchaser the contract provided that it would be liable only for liquidated damages in the amount of the earnest money deposited by it. Section 3 of the contract contains the following provision on this point:

> ". . . in the event that the Buyer shall default in the performance of any of its obligations under this Agreement, then the Escrow Agents shall redeliver the stock certificates and stock powers to the respective Sellers from whom they were received and the Sellers shall retain all payments of the purchase price theretofore made as liquidated damages." (R. Vol. II, 11).

The liquidated damages on default of Purchaser, which had a limited paid-in capital of $45,000 and no operating experience, would have been $500,000, already escrowed, to the entire group of Sellers. In contrast, to close it was

required to pay in cash $6,215,000, $2,000,000 of which was loaned to Purchaser under unusual circumstances by the bank which was Executor of the Dinkler Estate and the Estate itself. Mr. Dinkler's share of the liquidated damages on account of his Dinkler-Tutwiler Corporation stock would have been a little less than a third (31.6%) of the $500,000. Moreover, the Purchaser would not have been liable for even liquidated damages if the Sellers had failed to perform any one of the numerous conditions precedent to the consummation of the sale.

The executory contract, reprinted in full in the record (R. Vol. II, 6-34), contained many such conditions. Among these were (1) that all of the assets and properties must be free and clear of all liens and encumbrances (with certain specified exceptions) as of the closing date, (2) the stock certificates, deeds, bills of sale and releases required to pass title had to be delivered at closing, and (3) an opinion of counsel for the Dinklers, dated the closing date, was to be delivered as to the corporate existence and good standing of each of the corporations; requisite corporate action authorizing the sale of assets by the corporate seller; marketability and freedom from liens of the properties owned by each corporation; absence of judgments, suits, proceedings or investigations which might materially affect the business, assets, prospects or condition of the several corporations; and the absence of any default by any of the corporations under any other contract or indenture.

All of these conditions were unperformed on January 30, 1961, the date of the death of Carling Dinkler, Sr. Additionally, the consents of mortgagees holding large mortgages on the hotels in Birmingham and Atlanta had to be secured, and these consents had not been given by the mortgagees as late as February 10, 1961 (R. Vol. II, 154).

Also, regardless of the performance or nonperformance of the conditions, neither party would have been liable if the Dinkler Plaza Hotel in Atlanta had been taken in condemnation or destroyed by casualty, including fire, at any time before the closing.

Either party could terminate the unperformed contract to sell under the following circumstances as provided in Section 17:

> "In the event that prior to the closing there is a total loss of the Dinkler Plaza Hotel by casualty (including fire), whether or not compensable by insurance, or condemnation, then any party on notice to the other parties may elect to cancel this Agreement within ten days of such loss in which event all obligations of the parties (except with respect to the return of amounts paid by the Buyer) shall cease and terminate." (R. Vol. II, 33).

Of the $6,215,000 needed in cash (other than earnest money of $500,000) for the closing, the Purchaser on the date of Mr. Dinkler's death was short $2,350,000, or 37.8%. Equitable Life Assurance Society, the mortgagee of the Dinkler Plaza Hotel which was owed a balance of $1,400,000 (R. Vol. I, 120), had earlier refused to lend Associated this amount (R. Vol. I, 120).

Before Mr. Dinkler's death, Associated had discussed a loan at 15% interest (R. Vol. I, 123) with secondary sources. The officers and owners of Associated "had never sought these secondary sources before in any" of their financing of other transactions (R. Vol. I, 123).

After extensive negotiations the Trust Company of Georgia agreed to lend Purchaser $2,000,000, this constituting 32.2% of the cash funds needed by it to close the transaction. Of the $2,000,000, $500,000 was loaned to Associated by the Trust Company of Georgia as Executor

of the Estate of Carling Dinkler, Sr., and the remaining $1,500,000, the bank's then limit, was loaned by its Commercial Department. In regard to the $500,000 loan by the Executor, Carroll P. Jones, then a Senior Vice President of the Trust Company of Georgia with thirty years of experience and now Vice President and General Trust Officer, testified:

> "In fact, this is the only one [time] I have even [sic] participated in a loan to buy something from the very seller you represent." (R. Vol. I, 103).

Mr. Jones explained that one reason for the Estate's participation in the loan to the purchaser of the assets from the Estate was because "suddenly we found ourselves facing the responsibility as an executor of the ownership of a very big hotel chain." (R. Vol. I, 105).

Augustus H. Sterne, a Senior Vice President of the Trust Company of Georgia at the time of the loan and now its President, said that "the interest of the bank as executor of Mr. Dinkler's Estate was a compelling factor in the consideration" of the $2,000,000 loan (R. Vol. I, 95-96). Also, he testified that the bank did not seek the participation of other banks in the loan because he did not "really think it was a saleable piece of merchandise" (R. Vol. I, 95) and was not "of a high enough degree in my opinion to warrant our going and asking a correspondent to join us in making the loan." (R. Vol. I, 97-98).

The Commissioner of Internal Revenue held that the proceeds from the sale of the Dinkler-Tutwiler stock constituted income in respect of a decedent under Section 691 of the Internal Revenue Code of 1954, and further held that long term capital gain in the amount of $3,454,-863.56 was realized on the sale and that said gain was taxable to Petitioners. In a suit for refund under Title 28, U.S.C., Section 1346(a)(1), the United States District

Court for the Northern District of Georgia so held. This decision was affirmed by the United States Court of Appeals for the Fifth Circuit.

The Fifth Circuit held that the District Court reached its conclusion by applying the wrong test, i.e., "whether the post death payments are in fact due to the services performed by or the economic activities of the decedent", but that the result was correct because the decedent was "entitled to the income at the date of his death."

REASONS FOR GRANTING THE WRIT

I. The Fifth Circuit's Decision Creates Income Where None Existed at Decedent's Death and Subjects to Income Taxation Unrealized Enhancement in the Value of Property Never Before Brought Within the Purview of Income Taxation.

A. *Court of Appeals' Decision in Conflict with Distinction Between Property and Income.*

The series of positions taken by the Treasury Department on this subject during the 34 years since the first legislation—Section 42, Revenue Act of 1934—was passed have expanded the law beyond the intention of Congress and the language of the statute itself. Under this creeping process it took the Department 30 years to reach the position, applied in this case for the first time, that a capital gain based upon the existence of an unperformed executory contract to sell was "income in respect of a decedent" where the contract was first amended and then performed by the decedent's executor after the decedent's death. Thus it has reached the unsupportable position that income includes not only "items of gross income" as prescribed by § 691 but also items of property such as a right in an executory contract to sell.

The entire history of the pertinent legislation shows that Congress was concerned only with items of income,

enacting § 42 of the Revenue Act of 1934 to relieve the discrimination of taxing accrued income to a decedent on the accrual basis and not to one on the cash basis. After the Supreme Court in *Helvering v. Enright,* 312 U.S. 636 (1941) and *Pfaff v. Commissioner,* 312 U.S. 646 (1941) defined "accrued" as used in § 42 more broadly than previously used in an accounting sense, there was often an unfair bunching of such "accrued" income in a decedent's final prior-to-death computation period. Solely to remove this inequity § 126 of the Internal Revenue Code of 1939, same as § 691 for purposes of this case, was enacted to replace § 42. This relieved the bunching by taxing such income to the person—executor or beneficiary—actually receiving it in the year of receipt. There is no indication whatever in the Committee Reports or in the language of the statute itself that "items of gross income" was intended to include anything other than such "amounts [of income] accrued" up to the time of death as set forth in § 42 and defined in *Enright* and *Pfaff*. On this point *Merten's Law of Federal Income Taxation,* Code Commentary Volume, Section 691.3, is in full accord, such section providing in part as follows:

> "Under prior law it appeared to be generally held in the case of the sale of property that the sale had to occur prior to the decedent's death or the income arising from the sale would not be treated as income in respect of a decedent . . . . the precedents under the prior law would appear to have application under the new Code in determining what constitutes income in respect of a decedent where the sale of property is involved."

Both the House and Senate Committee Reports state that Section 126 was intended to tax income accrued up to the date of a decedent's death, as called for by Section 42, but they also state that Section 42 was changed to provide that such amounts should be taxed not in a de-

cedent's prior-to-death return but in the hands of the persons receiving such accrued income. The House Report is as follows on this point:

> "Since the Revenue Act of 1934 the revenue laws have contained provisions including in the income of a decedent for a period in which falls the date of his death all *income accrued* up to the date of his death not otherwise properly includible in respect of such period or a prior period. While *such income* should be subject to income tax, hardship results in many cases from including in the income for the decedent's last taxable period amounts which ordinarily would be receivable over a period of several years. This section changes the existing law by providing that *such amounts* shall not be included in the decedent's income but shall be treated, in the hands of the persons receiving them, as income of the same nature and to the same extent as such amounts would be income if the decedent remained alive and received such amounts." (Emphasis added). H.R. Rep. No. 2333, 77th Cong., 2d Sess. 83 (1942).

The income tax has never been applied to appreciation in value of property until such appreciation has been converted into "income" or gain by reason of a sale or exchange of property. This basic principle is recognized in Section 1014(a) of the Internal Revenue Code, which provides that "the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall . . . be the fair market value of the property at the date of the decedent's death . . ." If, and only if, the property passed from the decedent "constitutes a right to receive an item of gross income in respect of a decedent" does this rule not apply. Int. Rev. Code of 1954, § 1014 (c).

Mr. Dinkler's estate received from him at death, not "a right to receive an item of income," but property (stock of Dinkler-Tutwiler Corporation), subject to an unperformed, conditional, executory contract to sell, many of the conditions of which were unperformed and unperformable as of the date of the decedent's death.

The Fifth Circuit disregarded this time-honored distinction between *property* and *income* in holding that the proceeds of the sale of Mr. Dinkler's stock, when consummated by his executor after his death, was an item of income taxable to his estate and its beneficiaries under Section 691. The cases cited in support of its decision, except *Commissioner of Internal Revenue v. Linde*, 213 F.2d 1 (9th Cir. 1954), cert. den. 348 U.S. 871, all deal with income from personal services rendered prior to death or with rents due and owing as of the date of death. In *Linde* a sale or its equivalent had been made under local law by the decedent prior to death and only an account receivable undetermined in amount existed in favor of the decedent's estate. "No act or thing taken or performed" by the executor operated in that case "to give rise" to the payment in question. 213 F.2d at 4. At the date of the decedent's death, the grape crop had been delivered beyond recall, there were no unperformed conditions and no closing was required.

No case cited by the Fifth Circuit supports its holding in the instant case that an unperformed, conditional, executory contract to sell stock gives rise to income merely because it was entered into by a decedent prior to his death.

B. Keck Based on Economic Activities Test Rejected by Court of Appeals.

Keck v. Commissioner, 49 T.C. No. 31 (1968), decided by the Tax Court without knowledge of the Court of Appeals' decision in this case (R. Vol. III, 328), simply com-

pounds the error of the case at bar since the majority of a sharply divided Tax Court "strongly relied" upon the "economic activities" test of the District Court which test the Court of Appeals has now rejected. *U. S. Tax Week,* commenting on *Keck,* emphasized this point and the failure of both the Tax Court and the Fifth Circuit to apply Example (4) of the Regulation, saying:

> "Apparently, the Tax Court did not yet have available the opinion of the Fifth Circuit in *Trust Co. of Ga. v. Ross,* CA 5, 12/20/67, 1968 USTW 130, aff'g 262 F. Supp. 900 (N.D. Ga., 1966). Although it affirmed the result reached by the district court, the Fifth Circuit specifically disapproved the 'economic activity test' used there. Instead, it approved a test which looks to whether or not the decedent has a 'right to receive the income' at the time of death.
>
> * * *
>
> "Although the regulations are by no means the last word on interpretation of the tax laws, it seems strange that the majority in *Keck,* as did the Fifth Circuit, failed to even mention the regulation, cited in the dissent, which acknowledges that the statute does not apply to the typical stock purchase agreement effective upon death, even though the price formula was fixed in the agreement before death. Reg. § 1.691 (a) 2(b), Example 4 (R&J § 54.12(5))" 17 U.S. Tax Week 197, 199-200 (1968).

If the economic activities test, applied in *Keck* by the Tax Court and in the instant case by the District Court, were sound, the distributees of every decedent's estate would be compelled to take the decedent's tax basis for the purpose of determining income realized from the sale or other disposition by the distributees of every asset received from a decedent, where the decedent had engaged in any such activities, e.g., negotiations, prior to death.

Such a result was clearly not contemplated by Congress in the enactment of Section 691.

C. Court of Appeals' Failure to Apply Supreme Court Cases as to when Gain is Realized.

As early as 1919, this Court correctly defined "gain" from a capital investment. *Eisner v. Macomber,* 252 U.S. 189 (1920). At page 207, Mr. Justice Pitney said:

> "The Government . . . placed chief emphasis upon the word 'gain', which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived-from-capital';*—'the *gain-derived-from-capital,'* etc. Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being *'derived,'* that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description." (Court's emphasis.)

This language is consistent with the "entitlement" or "right to income" test *pronounced* but *incorrectly applied* by the Fifth Circuit in the instant case.

The record is devoid of any facts to support the Fifth Circuit's statement that the decedent, upon signing the contract to sell his stock, became entitled to or had a right to the income or gain eventually realized by the Executor on the sale of the stock. The facts as determined by the District Court negate such a proposition. That Court did not apply the right to income test, but rather relied upon the so-called economic activities test, finding that by reason of his activities and efforts income was produced or earned by the decedent prior to his death.

It is acknowledged that many conditions to Mr. Dinkler's obligations and to the obligations of the Purchaser remained unfulfilled until closing (Appendix A, p. A26),. Indeed, at least one such condition, completely ignored by both the Fifth Circuit and the District Court, which gave an avenue of escape to either side, was impossible of performance until the day of the actual sale, namely, the conditional termination of the contract, without liability, by either party in the event of destruction or condemnation of the Dinkler Plaza Hotel.

The Fifth Circuit holds (Appendix A, p. A4), that the entitlement test "has reference to the date of death of the decedent." It then simply states that the contract "created a right to these proceeds in Mr. Dinkler at the time the contract was executed." He had a "right" to the proceeds only if all of the conditions precedent to his obligations and those of the Purchaser were performed; if the Purchaser did not default in payment of the purchase price (as it almost did); if the Dinkler Plaza Hotel remained undamaged and intact until closing; and if no liens or encumbrances arose or were asserted materially affecting the value of the property to be conveyed—all of these "ifs" having reference *not* to the *date of the decedent's death,* but to the *closing date.*

In *Lucas v. North Texas Lumber Company,* 281 U.S. 11 (1930), this Court held that where a contract to sell property did not create an *unconditional liability* on the part of the vendee for the purchase price within the taxable year, the taxpayer "was not entitled" to return the proceeds of the sale as taxable income within that year, even though the taxpayer reported its income on the accrual basis.

The essential difference between an item of property and an item of income was clearly recognized in *Estate of Burnett v. Commissioner,* 2 T.C. 897 (1943), which

was acquiesced in by the Commissioner of Internal Revenue, 1944 Cum. Bull. 4. The Court held in favor of the taxpayer as against the Commissioner's contention that the fair market value of livestock and feed raised by the decedent not disposed of prior to his death should be included in computing the decedent's net income for the final period preceding his death. The Court emphasized that the "property had not been sold or exchanged by decedent at the time of his death" and that "No one was indebted to him for its fair market value". This principle was again approved by the Internal Revenue Service in Rev. Bull. 58-436, 1958-2 Cum. Bull. 366, 367, holding that the principles of *Burnett* are applicable under Section 691 even though *Burnett* was decided prior to the enactment of such section and prior also to the time of its counterpart, Section 126 of the Internal Revenue Code of 1939. In this same Revenue Ruling the Internal Revenue Service stated quite clearly that "income in respect of a decedent concerns items of income and not items of property." The Fifth Circuit failed completely to recognize this critical distinction.

D. Dinkler Contract Subject to Unperformed Conditions Precedent at Decedent's Death.

At the date of Mr. Dinkler's death he had no cause of action, either for the purchase price or for damages for the gain eventually realized or for specific performance of the contract. If this were a case in which equitable conversion had occurred the decision of the Fifth Circuit might be correct. Short of such a situation no right to the proceeds of the sale or income existed. No one, at the date of his death, could have predicted with any assurance that a sale would ever take place or a right to the proceeds would ever arise which would mature into an "item of gross income" under Section 691 or any other provision of the Internal Revenue Code. What is the legal nature of

Mr. Dinkler's right to income, if any, on the date of his death? The decision of the Fifth Circuit offers no answer to this all-important question of law.

It is highly speculative whether the contract would have been performed had Mr. Dinkler lived. With the Purchaser being short at Mr. Dinkler's death of $2,350,000 required to close, it is doubtful if Mr. Dinkler would have accepted an amendment to the contract resulting in his receiving $500,000 more in notes instead of such $500,000 in cash, and it is doubtful if the Trust Company would have loaned $1,500,000 since it then would not have been necessary for it to act to avoid having the responsibility of operating "a very big hotel chain" (R. Vol. I, 105). Also, it is not known whether secondary sources would have made the loan or whether Associated would have sought such a loan at the exorbitant cost of 15% interest (R. Vol. I, 123).

If, indeed, the statute has reference to the date of death of the decedent (as the Fifth Circuit held and we think correctly so), then the application of the test in the Fifth Circuit's decision is taxation by conjecture confirmed by hindsight, for on the date of his death, Mr. Dinkler had nothing more than a hope of performance of all the conditions including eventual payment of the purchase-price by a new corporation with a meager capital of $45,000 already, as of the date of death, resorting to methods bordering on those of desperation to raise the funds required. As a matter of law, the decedent had *no* right to income at the date of his death, just as "A" in Example (5)(1), Regulations, 1.691 (a)-2(b) had no right to income prior to his death (Appendix B p. B4).

II. The Decision of the Fifth Circuit Will Produce Uncertainty and Confusion in the Administration of Estates and Decides an Important Question of Income Tax Law which Has Not Been, but Should Be, Settled by this Court.

The decision of the Fifth Circuit extends the statutory language, "the amount of all items of gross income," to include what has never in the history of the income tax law been considered income of any kind, namely, unrealized appreciation in the value of property. Its impact upon the administration of estates and the taxation of income is enormous and far-reaching. Thousands of simple, unperformed, conditional contracts to sell property will, where the conditions precedent to closing eventually are performed after the death of the signer of the contracts, produce taxable income in situations not heretofore taxable. The purpose of Section 691 is to tax to the recipients income to which the decedent was *entitled* but had not collected on the date of his death. It was never intended to *create* taxable income by converting into gross income unrealized appreciation in property owned by a decedent, and not sold or otherwise finally disposed of, as of the date of death.

If the result reached by the Fifth Circuit is to become law, Section 691 should be amended by Congress rather than by judicial decision running counter to almost half a century of cases carefully construing the meaning of "income" for the purpose of taxation.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

FRANCIS SHACKELFORD

JAMES E. THOMAS

JOHN W. GILLON

Attorneys for Petitioners

_____, 1968

CERTIFICATE OF SERVICE

I hereby certify that I have this day mailed a copy of the attached petition with appendices to the Honorable Erwin N. Griswold, Solicitor General of the United States, Department of Justice, Washington, D. C. 20530, with sufficient postage attached.

This _____ day of _____, 1968.

Attorney for Petitioner